In the Supreme Court of the United States

OCTOBER TERM, 1978

KENNETH R. GROVES AND PEGGY L. GROVES, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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Solicitor General,
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The sole issue in this federal income tax case is whether the Government of the Trust Territory of the Pacific Islands is an "agency" of the United States within the meaning of Section 911 of the Internal Revenue Code of 1954, as amended (26 U.S.C.), so as to make the salaries paid by it to petitioners ineligible for the exclusion provided by that statute for earned income from sources outside of the United States. In this refund suit brought by petitioners, who were employed as teachers by the Government of the Trust Territory of the Pacific Islands, the district court (Pet. App. A24-A34) and the court of appeals (Pet. App. A1-A23) held that the Trust Territory Government was an "agency" of the United States so that their salaries paid by that government were not excludable from gross income under Section 911.

1. Section 911(a)(1) of the Code provides an exclusion from gross income for earned income received from sources outside of the United States. There are three requirements for qualification under the statute: (1) the amounts sought to be excluded must be from sources outside the United States; (2) during the entire period in question, the taxpayer must be a bona fide resident of a foreign country; and (3) the amounts must not be paid by "the United States or any agency thereof" (Pet. App. A35). There is no dispute that petitioners met the first two requirements of the statute; the question is whether they met the third requirement.

1. The courts below correctly held that the Government of the Trust Territory of the Pacific Islands is an "agency" of the United States within the meaning of Section 911(a)(1) of the Code. The jurisdiction of the United States over the Trust Territory of the Pacific Islands derives from the Trusteeship Agreement between the United States and the United Nations. That agreement provides that the United States shall have "full powers of administration, legislation, and jurisdiction over the territory" (Pet. App. A6). The administration of the Trusteeship was vested in the President of the United States by Section 1 of the Act of June 30, 1954, 68 Stat. 330 (48 U.S.C. 1681(a)), in which Congress directed (Pet. App. A6; footnote omitted):

> That until Congress shall further provide for the government of the Trust Territory of the Pacific Islands, all executive, legislative and judicial authority necessary for the civil administration of the Trust Territory shall continue to be vested in such person or persons and shall be exercised in such manner and through such agency or agencies as the President of the United States may direct or authorize.

In 1962, the President delegated exclusive authority to administer the Trust Territory to the Secretary of the Interior (Pet. App. A6-A7). The Secretary of the Interior thereupon established the Government of the Trust Territory of the Pacific Islands, pursuant to Department of Interior Order 2918 (Pet. App. A7). The Government of the Trust Territory, comprised of an executive, a legislative, and a judicial branch, remains under the direct control of the United States.

The Executive authority is vested in a High Commissioner, who is appointed by the President of the United States with the advice and consent of the Senate (Pet. App. A7; 48 U.S.C. 1681a). The legislature of the Islands, although elected by local citizens, is limited in its lawmaking functions to passing laws not inconsistent with treaties or international agreements of the United States, laws of the United States applicable to the Trust Territory, Executive Orders of the President of the United States, and Orders of the Secretary of the Interior (Pet. App. A7). The judicial branch of the Government is headed by a High Court composed of three justices appointed by the Secretary of the Interior (Pet. App. A7-A8). Furthermore, the overwhelming percentage of funding of the Trust Territory Government (98 percent in 1971 and 94 percent in 1972) is provided by appropriations and grants from the United States (Pet. App. A10, A19).

In sum, the Trust Territory Government was created by the United States for the purposes of carrying out its responsibilities under the Trusteeship Agreement. The powers of the Government are derived solely from the United States. The Trust Territory Government is an

"agency" of the United States within the meaning of Section 911.[1]

2. Contrary to petitioner's contention (Pet. 7-8), the decision below does not "usurp" the power of Congress. Indeed, the decision is in accord with those of other courts construing the term "agency" as used in Section 911 and other provisions of the Internal Revenue Code. See, *e.g.*, *Kalinski* v. *Commissioner*, 528 F. 2d 969 (C.A. 1) (United States Air Force Europe Child Guidance Center is an "agency" of the United States under Section 911); *Bell* v. *Commissioner*, 278 F. 2d 100 (C.A. 4) (Government of American Samoa is an "agency" of the United States under 26 U.S.C. (1952 ed.) 251).[2]

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

NOVEMBER 1976.

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[1] *Porter* v. *United States*, 496 F. 2d 583 (Ct. Cl.), and *People of Saipan* v. *United States Dept. of Interior*, 502 F. 2d 90 (C.A. 9), upon which petitioners rely (Pet. 8), are distinguishable. Those cases respectively held that the Trust Territory Government was not an "agency" of the United States for purposes of contract or the National Environmental Policy Act of 1969. In the latter case, the court recognized that the status of the Trust Territory Government might be resolved differently for tax purposes (*id.* at 95).

[2] In *McComish* v. *Commissioner*, 64 T.C. 909, on appeal, C.A. 9, No. 76-1486, the Tax Court also held that the Government of the Trust Territory of the Pacific Islands was an "agency" for purposes of Section 911.